# Regulatory developments in East Africa

*Marc Hammerson and John LaMaster, Partners in the London office of Akin Gump*, discuss ways in which East African governments have adapted to the heightened commercial interest in regional oil and gas opportunities.*

East Africa's petroleum industry was, for many years, in the shadow of states such as Angola and Nigeria (to the west) and Algeria and Libya (to the north). Those states hold vast reserves and are significant producing nations. However, their petroleum basins are now considered mature provinces and, more recently, the search for new resources has focused on countries along the Great Rift Valley. This geological structure starts in Jordan and extends 4,000 miles south to offshore Mozambique. It covers Ethiopia, Uganda, Rwanda, Kenya, Tanzania and Democratic Republic of Congo.

Large oil discoveries have recently been made in Uganda and Kenya. Further south, Tanzania and Mozambique hold significant natural gas potential. Because of their common geology, these countries are beginning to benefit from the attention of more competent and better financed oil companies. Increased competition for exploration assets also causes governments to consider the benefits that they receive from licensing these assets.

Governments, particularly in jurisdictions with no history of petroleum developments, require international capital to pay for, and foreign expertise to conduct, petroleum activities. Both are scarce resources – and governments compete in the international marketplace for exploration dollars. A country with no history of exploration success must offer attractive terms. However, once discoveries are made governments often change the investment climate. We have seen this recently across East Africa in well publicised cases. This trend is likely to continue.

## Taxing times

A government's principal benefit in licensing petroleum rights is the generation of revenue. New petroleum-producing countries compete for investments and keep tax rates competitive. A country with proven resources, in contrast, can demand a higher fiscal return. There are signs that East African governments are becoming more assertive on tax. The recent sale of Cove Energy, a UK company with East African assets, provides an example. Cove structured its takeover so that tax was not payable in Mozambique. The government, having previously received no tax from a cross-border merger in the mining sector, was determined to benefit from this $2bn deal. During the acquisition process it announced a new law imposing capital gains tax at 12.8% on the sale of non-Mozambican companies holding local assets. The announcement of a new tax during a public takeover affected Cove's valuation, delayed the acquisition and led to the successful bidder paying an increased price to compensate for the additional tax.

The imposition of this new tax in Mozambique followed a dispute in Uganda resulting from Heritage Oil's sale of petroleum interests to Tullow Oil. The parties similarly structured the transaction in the belief that no capital gains tax was payable. The tax tribunal disagreed and based its ruling on the location of the petroleum assets. To add to the parties' difficulties, the government withheld its consent to Tullow developing the assets (and selling a part-share to finance this) until Tullow provided security for the tax payment. In order to obtain the required consents, Tullow paid the tax and reclaimed the amount from Heritage. This prompted further litigation between the commercial parties regarding responsibility for tax payments.

These are examples of increasing government confidence. Despite adverse publicity accompanying such disputes, governments feel assured that their exploration opportunities are attractive enough to foreign investors to withstand negative press coverage.

In order to reach a position in which a petroleum project is producing (and therefore generating revenue for the host government) an international oil company must first conduct exploration. The government requires that exploration is performed to a minimum level (including use of 3D seismic surveys), within an agreed timeframe and subject to a minimum expenditure. The periods by which these obligations must be performed can be extended with government consent. Historically, there has been an assumption that governments are willing to grant extensions with limited questioning. However, now that oil production is a priority, extensions are likely to be subject to increased scrutiny. Regional governments are eager to obtain the benefits from their newly-discovered resources and are unwilling to grant extensions to licensees who have been non-compliant in performing work obligations. These trends have also been seen in the mining sector.

## National priority

During a time when there was little regional interest from the oil majors, countries issued speculative licences to small exploration companies. It is apparent that some of these companies lack the financial strength and know-how to exploit the resource potential. Production is now a national priority – and more credible companies are showing an appetite to acquire exploration positions in the region. East African governments are in the future likely to be less forgiving of both large and small companies that fail to comply with work programmes. There is no shortage of better financed and more technically competent companies willing to invest in East African opportunities – and companies that can demonstrate these qualities will be better placed to be successful in forthcoming licensing rounds.

An increase in the manpower and budgets allocated to exploration in East Africa will benefit both the development of the region's oil and gas industry, and the employment and social benefits which are generated by a thriving petroleum sector.

**Hammerson and LaMaster are also co-editors of a book on African oil and gas law due to be published in 2014.*